RESEARCH HIGHLIGHTS

Socio-Economic Series Issue 47

THE ROLE OF PUBLIC-PRIVATE PARTNERSHIPS IN PRODUCING AFFORDABLE HOUSING: ASSESSMENT OF THE U.S. EXPERIENCE AND LESSONS FOR CANADA

Introduction

The emergence of the partnership approach in producing affordable housing began under a set of circumstances in the United States (U.S.) that were quite similar, although occuring ten years prior, to the more recent experience in Canada. Prior to the 1980s, federal housing subsidy programs in the United States were the primary vehicles to develop affordable rental and homeownership opportunities. In the early 1980s, the U.S. Department of Housing and Urban Development's (HUD) budget authority for new housing commitments was cut by over 70 percent. At the same time, state and local governments were also under budget-cutting pressures, which limited their ability to fill the gap. Over the ensuing 15-year period, an apparent "system-wide" public-private partnership (PPP) approach, involving the widespread participation of corporations, philanthropies, foundations, lenders, financial investors, and the non-profit sector, evolved to such an extent that this new paradigm has become almost the sole approach used to produce affordable housing.

Research Program

The purpose of this research project was to examine the American experience with a view to identifying initiatives and mechanisms that might help to strengthen and broaden current efforts to initiate affordable rental and homeownership PPPs in Canada. In order to assess the potential transferability and/or adaptability of the U.S. experience, allowance had to be made for the significant differences between the two countries' socio-economic, financial, political contexts and environments.

The report first reviews the historical factors and circumstances that bred the PPP approach in the U.S. This evolutionary period is contrasted with the conditions that prevailed in Canada. Part 1 of the report briefly reviews and presents a conceptual framework to describe and illustrate how the range of mechanisms and measures are used to patch together the financing needed to produce affordable housing. Part 2 introduces and reviews a set of illustrative case studies that were used to examine in greater detail how affordable housing projects and partnerships are structured and financed in the U.S. The key features of affordable housing projects and PPPs are highlighted. Part 3 provides a brief overview of the Canadian context and reviews a smaller set of Canadian case studies. The experience in each country is juxtaposed as a way to help understand the differences that exist and the potential of some of the U.S. mechanisms to be adapted to fill voids in the Canadian system. An overall assessment of the U.S. experience and the opportunities to expand the production of affordable housing in Canada through PPPs are the subject of Part 4.

Three detailed appendices are included in the report. They contain, respectively, greater detail on the mechanisms, measures, and roles of key partners (Appendix A), profiles of the 15 U.S. case studies (Appendix B), and profiles of the 7 Canadian case studies (Appendix C).

Findings

The Evolution of PPPs in the U.S. and Canada

The emergence of partnership approaches in the U.S. began under a set of fiscal circumstances that were quite similar to our own experience in Canada. The initial stimulus in the U.S. was

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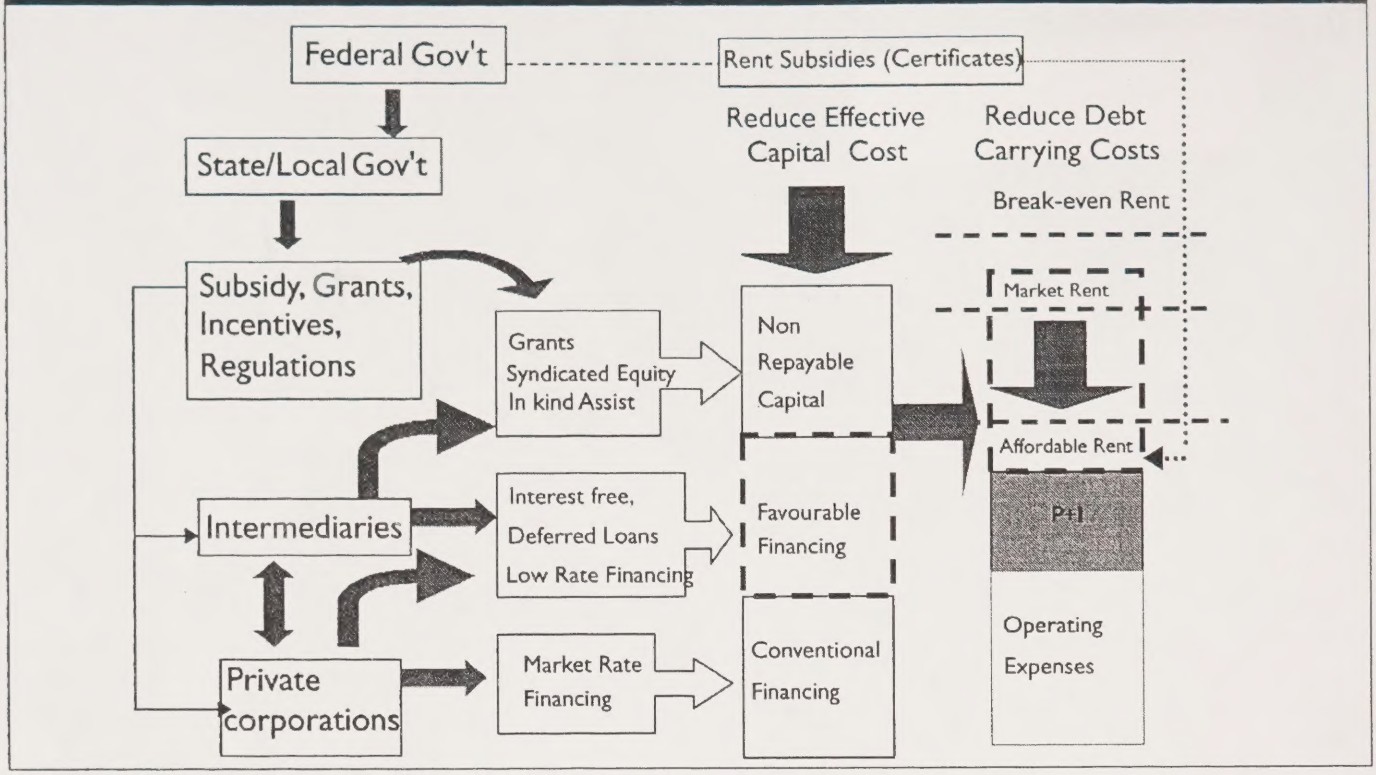
Figure 1: Conceptual Framework - US Partnership Model



the drastic cut to housing budgets implemented by the Reagan administration's 1981 Omnibus Budget Reconciliation Act.

Unlike the situation in Canada through the 1970s and 1980s, low-income housing programs in the U.S. have historically provided only limited funding for community-based non-profit housing development. As a direct consequence, the community-based non-profit sector became very creative and entrepreneurial—forging alliances with local government, the foundation and philanthropic sector (which is far more substantial in the U.S.) and, where possible, with private corporations. Opportunities to develop alliances in joint ventures and PPPs were reinforced in the late 1970s when Congress enacted legislation "encouraging" lenders to remedy the practice of selective lending and so called "redlining" under which low-income (and often minority) households and low-income neighbourhoods were precluded from access to mortgage financing.

The community-based sector became adept at producing, or more often preserving, affordable housing by creatively latching onto available resources and cobbling together a project. Thus, the PPP approach for creating affordable housing in the U.S. was borne out of both circumstance and need. They were not conceived as an explicit policy objective of the federal government—although more recently PPPs have been encouraged and facilitated by a number of federal policy initiatives. Moreover, despite the label "public-private partnership," most partnerships are rooted in the non-profit sector.

Conceptual Framework of PPPs in the U.S.

Concurrent with the emergence of PPPs, the U.S. housing system has transformed from a relatively homogenous—so-called "plain vanilla"—government program expenditure driven system to one characterized by multiple participants involved in any one project. There is also considerable diversity in the nature of the arrangements and mechanisms used to procure affordable housing.

A key feature of the U.S. approach is that most of the measures and mechanisms focus on the financing aspect of the project or partnership. There is a heavy reliance on mechanisms that reduce debt costs (see accompanying figure on conceptual framework). Affordability is pursued by minimizing debt service costs so that the break-even rent is relatively affordable and the project is viable without the need for ongoing government subsidy assistance to reduce rents to affordable levels. With the exception of some projects that have secured a rent supplement type of assistance, or in cases where individual households benefit from a shelter allowance program, rents are not directly subsidized.

The Role of the Public Sector

For the most part, the U.S. approach now involves low-cost or "no cost" financial support. These come through a number of sources but invariably involve some form of direct or indirect up-front public subsidy. Most financing subsidies originate at the

federal level but flow through local and state government in the form of block grants. States and localities augment these with their own funds. Together, the Community Development Block Grant, which has been funded since 1974, and the more recent HOME Investment Partnership program (created by consolidating other existing programs in 1990), provide more than $5 billion (1998 appropriations) to states and localities for community revitalization—much of which involves housing rehabilitation and development.

With this significant source of federal funding, localities have been stimulated to add some of their own funds and to create a wide array of programs and mechanisms used to create affordable housing through PPPs. Many cities have established formal partnership agencies, autonomous from the local government, drawing on the expertise and financial participation of community and corporate partners. These autonomous and well-resourced local PPPs have proven to be extremely flexible and responsive in developing local programs that meet local affordable housing need—though not necessarily the very lowest income need.

Two major sources of "no cost" financial support for new development are derived from the federal tax system in the forms of Low Income Housing Tax Credits (LIHTC) and tax-exempt bonds. LIHTC-induced equity investment often represents 30% to 50% of the capital costs of new low-income rental housing. Unlike debt, there is no repayment; it is pure equity. As such, it is a critical feature in producing housing in which rents are affordable. LIHTC tax expenditures cost the U.S. Treasury approximately $3 billion a year. In addition, tax-exempt mortgage bonds have also provided states and municipalities with a low-cost source of capital (i.e. $2 billion/year) to finance affordable multi-family rental housing developments.

Key elements of the U.S. PPP system derive from legislated "encouragement." Most prominent is the Community Reinvestment Act (CRA), which requires financial institutions to reinvest a specified proportion of their deposits back into the local community and specifically prohibits "redlining" of distressed and low-income areas. In the early 1990s, the CRA provisions were complemented by further legislation that imposes targets on the loans purchased by the large secondary mortgage market government-sponsored enterprise (GSE) institutions—Fannie Mae and Freddie Mac. A specific percentage of the loans that they purchase must meet affordable housing criteria. In responding to this legislated mandate, these institutions have initiated a series of innovative mortgage underwriting products broadly aimed at supporting and encouraging individual lender to originate affordable housing loans. These lending products are also designed to minimize and mitigate the risk inherent in serving low-income borrowers.

The Role of Intermediaries

At the core of the U.S. PPP approach is the network of so-called "intermediaries" that have emerged. These exist at both the national and local level and provide a range of services to assist community-based organizations. This includes helping to build and expand local capacity, attracting corporate donations, development assistance, lending and granting programs, and supporting an advocacy network. With the creation of the LIHTC in 1986, intermediaries have taken on a significant role as syndicators and conduits for tax credit investment pools. This has enabled them to expand their education, advocacy, and capacity-building activities so that non-profit operators rehabilitating and building affordable housing have access to the skills required to develop and manage these assets (as well as designing and delivering a range of other community services).

The non-profit financial intermediaries that exist in the form of equity funds, trust funds, and large corporate entities—which in comparison make CMHC look small—are overseen by voluntary boards comprised of leaders in corporate America. They wield considerable power and influence and are an important constituency in gaining political support for community development and affordable housing.

The Role of Philanthropies

The U.S. philanthropic sector has played an important role in helping to establish and expand the infrastructure for partnerships. At the largest scale, philanthropists were the catalysts in establishing the two largest national housing partnership intermediaries—the Local Initiatives Support Corporation (LISC), created in 1979 by the Ford Foundation, and the Enterprise Foundation, created by the late James Rouse, a large real estate developer and philanthropist. LISC and Enterprise have gone on to become major organizations, acting very much like corporations (but with non-profit status and a strong social purpose). On a smaller scale, foundations provide extensive financial support to help establish and develop the expertise of community groups, support research of social issues, and undertake advocacy activities with the aim of influencing public policy reform.

Although the philanthropic sector is very large, its involvement in housing is limited. Foundations seldom provide equity investment to facilitate project development. They recognize that housing development is a very specialized activity, better left to the experts, and that, alone, their individual grants would not be sufficient to make projects viable. Their main contribution to project financing is indirectly through

contributions to housing funds. These funds then create low-interest loan pools, which can be used to provide either a layer of the overall financing packages or grants that help community groups enhance the quality of life in affordable housing (e.g. by providing child care, employment counselling, etc.).

The Role of the Case Studies

The illustrative case studies included in the report reveal the variety of mechanisms that have been developed for U.S. PPPs as well as the range of successes that have been achieved. One characteristic is especially notable: many communities have identified the existing housing stock as a valuable resource. This, in part, is due to urban distress and neighbourhood deterioration in many cities; but it also reflects the reality that, with only limited financial resources, a greater impact can be achieved in creating affordable housing by working with existing properties where the costs are inherently lower. This maximizes the use of scarce funds in achieving the goal of providing a significant volume of affordable housing.

These approaches are especially prevalent in the cases that did not utilize the relatively generous LIHTC. In a number of cases they involve affordable homeownership initiatives—combining low-cost acquisition with rehabilitation, financial counselling and ownership education, and specialized underwriting and lending products designed specifically (under the auspices of the GSE's affordable housing goals) to assist what would traditionally have been seen as more marginal borrowers. Public financial support (often in the form of preferred rate or deferred interest soft second mortgages) and a policy framework, including legislated requirements, have been used as tools to enhance the creditworthiness of low-income borrowers and to ensure the financial viability of projects. This public support effectively mitigates risk and is an important consideration in attracting the participation of private lenders in funding affordable housing mortgages.

The Canadian cases reveal some promise. A number of communities are seeking to emulate some of the U.S. practices—most notably in developing acquisition and rehabilitation approaches and seeking to establish housing trust funds. However, these initiatives have been very limited to date and have yet to achieve success in serving low-income households or in producing a significant volume of housing.

Conclusion

The U.S. experience shows that affordable housing can be produced through PPPs. However, it must be borne in mind that this achievement is based on significant levels of upfront public financial assistance provided through various grant and tax credit programs. These subsidies, combined with policy support, have leveraged additional private-sector financing in support of the goal of providing affordable housing. They have stimulated the growth of a wide array of intermediaries and specialized affordable loan products. Over time, the system has grown and built on itself and now produces almost 100,000 units of affordable housing annually.

Not all features of the U.S. system are either desirable or appropriate, and, in many cases, the circumstances in Canada do not lend themselves to the wholesale adoption of the U.S. model. In particular, without financial vehicles like tax-exempt bonds and tax credits, the related capacity for an intermediary network to develop and sustain itself (through syndication fees) is very limited.

The U.S. experience clearly suggests that some level of funding—but not necessarily ongoing subsidies—is a critical prerequisite to encourage and stimulate financial support from other sources and to stimulate the creation of mechanisms that can act to stretch limited public investment further. The PPP approach to creating affordable housing is only as good as the tools and funding mechanisms that they have at their disposal.

Foremost among the recommendations outlined in this study is the proposal that CMHC work in collaboration with the provinces and territories to help establish local housing trust funds. This could be an effective way to stimulate the creation of local housing partnerships and to fuel development of locally designed affordable housing initiatives.

Addendum - Facilitating the Production of Affordable Housing in Canada

CMHC and the Canadian Centre for Public-Private Partnerships in Housing

CMHC's Canadian Centre for Public-Private Partnerships in Housing (CCPPPH) promotes and facilitates partnerships to increase the supply of affordable housing. The Centre gives advice on legal, financial and regulatory solutions, experiments with new financing and tenure agreements and disseminates information on successful practices. The Centre actively seeks out partnerships, especially at the grassroots level with such organizations as non-profit agencies, builders, developers and municipalities and other federal and provincial government departments and agencies. Since inception, the Centre's support has led to more than 180 projects with more than 10,000 units of affordable housing for seniors, families, single persons and people with disabilities. Currently more than 50 affordable housing projects are developed annually with the assistance of the CCPPPH.

The Centre provides a number of tools to assist in developing affordable housing including:

- "best practices" guides;
- parnership research;
- "one on one" consultation and expert advice, a vast network of potential partnership leads, interest-free Proposal Development Funding (PDF) loans;
  and
- facilitating access to mortgage insurance allowing groups to access low-cost housing financing.

Over the last few years, CMHC has been involved in a *Homegrown Solutions* partnership initiative with the Canadian Housing and Renewal Association (CHRA), the Canadian Home Builders' Association (CHBA), the Federation of Canadian Municipalities (FCM) and the Co-operative Housing Federation of Canada (CHF). Since 1997, this initiative has provided seed money of up to $20,000 per applicant for demonstration projects that encourage and support community partnerships to address local housing needs.

CMHC Research on Producing Affordable Housing in Canada Through PPPs

CMHC has completed a number of research reports and case studies, available through CMHC's Canadian Housing Information Centre, which examine a range of alternative measures which could be employed to support the creation of affordable housing in Canada through public-private partnerships. The following lists both published reports currently available and upcoming research to be published in the near future.

Published Research

1. Guide to Affordable Housing Partnerships
2. New Ways to Create Affordable Housing: Results of a National Survey of Housing Providers
3. Municipal Regulatory Initiatives: Providing for Affordable Housing
4. Affordable Housing Solutions - Fifteen Successful Projects
5. Public-Private Partnerships in Municipal Infrastructure - Theory and Practice
6. Municipal Regulation, Land Use Planning and Financial Measures to Encourage New Affordable Housing Production

Upcoming Research

1. Housing Trust Funds: Their Nature, Applicability and Potential in Canada
2. A Workbook to Create a Housing Trust Fund in Canada
3. The Affordable Housing Advisor
4. Background Research on Philanthropic Support for Affordable Housing
5. Philanthropic Support for Affordable Housing

For more information about the nature and kinds of support services and assistance which the CCPPPH and its experienced team of afforable housing partnership experts can provide, contact the nearest CCPPPH representative in your area:

Atlantic:	Thomas Levesque, tlevesque@cmhc-schl.gc.ca	tel.: (902) 426-8430
Québec:	Claudette Dupuis, cdupuis@cmhc-schl.gc.ca	tel.: (514) 283-2203
Ontario:	Len Bulmer, lbulmer@cmhc-schl.gc.ca	tel.: (416) 218-3341
Prairie, Nunavut & NWT:	Bill Joyner, bjoyner@cmhc-schl.gc.ca	tel.: (403) 515-3011
B.C./Yukon:	Steve Hall, shall@cmhc-schl.gc.ca	tel.: (604) 666-4660

Project Manager: David Metzak

Research Report: The Role of Public-Private Partnerships in Producing Affordable Housing: Assessment of the US Experience and Lessons for Canada

Research Consultant: Steve Pomeroy (Focus Consulting) and Greg Lampert in association with James Wallace (ABT Associates) and Robert Sheehan (Regis J. Sheehan and Associates)

A full report on this project is available from the Canadian Housing Information Centre at the address below.

Housing Research at CMHC

Under Part IX of the National Housing Act, the Government of Canada provides funds to CMHC to conduct research into the social, economic and technical aspects of housing and related fields, and to undertake the publishing and distribution of the results of this research.

This fact sheet is one of a series intended to inform you of the nature and scope of CMHC's research.

The **Research Highlights** fact sheet is one of a wide variety of housing related publications produced by CMHC.

For a complete list of **Research Highlights**, or for more information on CMHC housing research and information, please contact:

The Canadian Housing Information Centre
Canada Mortgage and Housing Corporation
700 Montreal Road
Ottawa, ON K1A 0P7

Telephone: 1 800 668-2642
FAX: 1 800 245-9274

OUR WEB SITE ADDRESS: http://www.cmhc-schl.gc.ca/Research